

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)
)
Applications of WorldCom, Inc.)
and MCI Communications Corp.) CC Docket No. 97-211
for Transfer of Control of)
MCI Communications Corp.)

To: The Commission

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

**COMMENTS OF SIMPLY INTERNET, INC.
IN RESPONSE TO WORLDCOM/MCI JOINT REPLY**

SIMPLY INTERNET, INC.

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SUMMARY

The WorldCom/MCI Joint Reply fails to provide any substantive or factual basis for approval of the proposed merger. Rather, the Joint Reply consists of little more than broad-brush dismissals of the possibility of any adverse competitive impact in the Internet backbone services market, with the apparent view by WorldCom/MCI that if they avoid putting facts on the table, the issues will simply go away. Yet the issues are critical to the future of telecommunications in the U.S. and beyond, and cannot be so easily ignored. Until adequate, detailed, and accurate information is presented by WorldCom/MCI, the Commission is in no position even to begin to undertake the overall competitive analysis required by BellAtlantic/NYNEX, 12 FCC Rcd 19985 (1997) and other recent precedent.

To the extent that the WorldCom/MCI Joint Reply actually address the issues raised by Simply Internet and others, the reply falls on its face. WorldCom/MCI appear to suggest that because the Commission has stated that it will not regulate the Internet, then the Commission should not even concern itself with allegations regarding competition in the Internet backbone marketplace. However, approval or disapproval of a merger of the two dominant providers of Internet backbone services is hardly a case of "over-regulating" the Internet. The level of competition among Internet Service Providers ("ISPs"), the point of entry into the Internet for consumers, is intense. That consumer

competition will wilt on the vine, however, if one entity is permitted to control roughly 50% of the basic backbone infrastructure necessary for ISPs and other critical players to exist.

Perhaps most revealing is WorldCom/MCI's failure to provide any significant marketplace factual information to support its bald claims that the proposed merger will not lead to an excessive level of concentration in the Internet backbone market. Except for a rough 20% calculation incorrectly based on overall Internet industry revenues, no market share information whatsoever is provided, let alone the Herfindahl-Hirschman analytical data the Commission normally requires in situations such as this. Nor can WorldCom/MCI hide behind its unsupported assertion that there is no separate Internet backbone services market. The fact is that the Internet backbone services market is well-established and well-recognized within the Internet industry as a separate and distinct marketplace.

Furthermore, contrary to WorldCom/MCI's claim, there are substantial barriers to entry into the Internet backbone market due to the need for new entrants to rely upon the existing dominant backbone providers to gain even a small foothold in the market. WorldCom/MCI's market control also extends to Internet Protocol ("IP") addresses, a fact that which WorldCom/MCI fail to accurately portray or to rebut in their reply. Finally, WorldCom/MCI substantially underestimate the problems and potential for harm caused by

changes in peering arrangements which provide a substantial disincentive for an ISP to switch backbone service providers and therefore further constrict the marketplace.

The Commission cannot consider the WorldCom/MCI merger without obtaining, reviewing, and making available far more information than is currently before it. Some of the information that the Commission requires may be contained in the Hart-Scott-Rodino ("HSR") information that has been and is being requested by the Justice Department. The Commission should obtain that HSR information, and make it available to the parties pursuant to well-established procedures. Unless and until that occurs, the record before the Commission is incomplete and inadequate to approve a merger of the size and potential impact of the WorldCom/MCI merger.

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Pursuant to the procedures specified in the Common Carrier Bureau's Order (DA 98-384) of February 27, 1998 ("Order"), Simply Internet, Inc. ("Simply Internet") submits the following comments in response to the "Joint Reply of WorldCom, Inc. and MCI Communications Corporation to Petitions to Deny and Comments" (hereinafter "WorldCom/MCI" and/or "Joint Reply"), filed January 26, 1998.

While long on rhetoric and academic discussion, the WorldCom/MCI Joint Reply is all but devoid of concrete factual information disputing the *prima facie* case made by Simply Internet and others with respect to the adverse competitive impact of the proposed merger in the Internet backbone services market. WorldCom/MCI contend at length that the extensive marketplace information and competitive

analyses supplied by Simply Internet and other petitioners are incorrect or misread the marketplace, but they never proffer any hard information or reliable economic analysis to document their claims to the contrary.

Under both Title II and Title III of the Communications Act, before transfer of the licenses and authorizations underlying the proposed merger can be approved, the Commission must be persuaded that the merger is in the public interest, convenience and necessity. More specifically, the burden is on WorldCom/MCI:

applicants bear the burden of demonstrating that the proposed transaction is in the public interest. . . . Our examination of a proposed merger under the public interest standard includes consideration of the competitive policies underlying the Sherman and Clayton Acts--the Commission is separately authorized to enforce Section 7 of the Clayton Act in the case of mergers of common carriers--but the public interest standard necessarily subsumes and extends beyond the traditional parameters of review under the antitrust laws. In order to find that a merger is in the public interest, we must, for example, be convinced that it will enhance competition. . . . If applicants cannot carry this burden, the applications must be denied."¹

A variety of petitioners, including Simply Internet, have made a strong *prima facie* showing that the merger of the largest and third-largest Internet backbone provider ("IBP") companies in the United States will create an excessive degree of market concentration in the national

¹ Application of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee, for Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries, 12 FCC Rcd. 19985, ¶ 2 (1997) (hereinafter cited "Bell Atlantic/NYNEX").

Internet backbone services market which will severely hamper the free and competitive development of the overall Internet services industry. The issue involves substantial and material questions of fact which go to the heart of the Commission's regulatory responsibilities under both Title II and Title III of the Communications Act. In response, as hereinafter shown, WorldCom/MCI have utterly failed to rebut this *prima facie* showing or satisfy their ultimate burden of demonstrating that the proposed merger will have no adverse competitive impact in the Internet backbone marketplace.

If nothing else, "the totality of the evidence arouses a sufficient doubt on the point that further inquiry is called for." Citizens for Jazz on WRVR v. FCC, 775 F.2d 392, 395 (D.C. Cir. 1985). Accordingly, Sections 214 and 309 of the Communications Act require the Commission to designate the WorldCom/MCI application for evidentiary hearings. Stone v. FCC, 466 F.2d 316 (D.C. Cir. 1972).

At the minimum, WorldCom/MCI's application should at least be subjected to other minimal fact-finding procedures to develop a fuller factual record before the Commission for decision. Pursuant to established Commission procedures as set forth in Bell Atlantic/NYNEX, *supra*, and AT&T/McCaw, 9 FCC Rcd 5836 (1994), the current absence of a sufficient factual record requires the Commission to order WorldCom/MCI to submit all non-public Hart-Scott-Rodino materials filed with the Department of Justice to the Commission for immediate review by the Commission and (subject to

appropriate protective orders) the parties to this proceeding.

II. The Joint Reply Does Not Supply Sufficient Factual Information to Analyze the Competitive Implications of the Merger on the Internet Backbone Marketplace.

Initially, WorldCom/MCI's claim that the Commission should not be concerned with competitive consequences of their proposed merger on the Internet backbone marketplace because the Commission does not have jurisdiction over the Internet must be dismissed. WorldCom/MCI Joint Reply pp. 67-68. Simply Internet agrees with basic Congressional and Commission policy to keep the Internet free from governmental regulation. This, however, is not the issue. It does not mean that the Commission must blind its eyes to the adverse competitive consequences on the Internet backbone marketplace that would result from merger of two already immense regulated telecommunications companies. This is not a case of the FCC "regulating" some aspect of the Internet -- rather it is a case in which the FCC must act to ensure the preservation of competition in the emerging Internet industry by limiting the ability of a single company to have a commanding market dominance over the Internet backbone provider ("IBP") marketplace.

WorldCom/MCI argue at length as to what is wrong with the petitioners' showings, contending, for example, that their alleged control of over 50% of the Internet backbone market is "based on unreliable data and an analysis that is

fundamentally flawed." Joint Reply, p. 75. To contest these claims, WorldCom/MCI endeavor to paint a panoramic mural of an exploding marketplace with no barriers to entry and no potential for competitive abuse by current competitors. What is significantly lacking, however, is valid and reliable marketplace data and information to support these broad-brush claims.

Stripping aside the verbiage of an open and competitive marketplace depicted by WorldCom/MCI, their Joint Reply supplies only three conclusory tidbits of potentially significant factual marketplace information -- a combined WorldCom/MCI will control only 31.6% of total interexchange fiber miles (Joint Reply, p. 72), will have only 20% of total Internet industry revenues (Joint Reply, p. 76), and will operate only 7 of 39 network access point (NAPs) in the United States (Joint Reply, pp. 86-87). None of these factors (accepting them as true for purposes of argument) serves to describe adequately competitive conditions in the Internet backbone services market or provide the Commission with sufficient economic data to undertake the required competitive analysis.

The Bureau's February 27th Order specifically requests the parties to apply "the merger framework the Commission articulated in the Bell Atlantic/NYNEX and BT/MCI merger proceedings to the proposed merger at issue in this proceeding." Order, ¶ 4. Under this policy, the starting point for such analysis is the definition of the relevant

market and identification of the number and size of existing market participants. As explained by the Commission in Bell Atlantic/NYNEX:

In evaluating the competitive impact of a proposed merger and thus whether a proposed merger will enhance competition, we use a framework for competitive analysis that we use for assessing market power in other contexts and that is also embodied in the antitrust laws, including the Department of Justice and Federal Trade Commission 1992 Horizontal Merger Guidelines and the April 8, 1997 revisions. With respect to mergers that may present horizontal market power concerns, we begin by defining the relevant markets, both in terms of the relevant products and geographic scope. Once we have defined the relevant markets, we identify the market participants, especially the most significant market participants. Next, we evaluate the effects of the merger on competition in the relevant market, such as whether the merger is likely to result in either unilateral or coordinated effects that enhance or maintain the market power of the merging parties. In addition, we also consider the effect of the merger on the Commission's ability to constrain market power as competition develops, but before competition is itself sufficient to constrain market power. We also consider whether the proposed transaction will result in merger-specific efficiencies such as cost reductions, productivity enhancements, or improved incentives for innovation, and whether the merger will support the general policies of market-opening and barrier-lowering that underlie the 1996 Act. In the appropriate case, we would also examine whether the proposed merger has vertical effects that enhance market power. As previously discussed, the burden is on the applicants to demonstrate that the transaction will be in the public interest, convenience and necessity.²

From this basic analysis then flows an evaluation of the various factors affecting marketplace entry and conduct,

² Bell Atlantic/NYNEX, ¶ 37 [footnotes omitted].

such as the relative ease of entry and the effect of individual conduct and practices on the marketplace.

While challenging the concentration analyses (Herfindahl-Hirschman Index, or "HHI") submitted by Simply Internet and others, WorldCom/MCI at this point have not even provided the Commission with their own HHI analysis or sufficient data for the Commission independently to conduct such an analysis on a reliable basis. Compare Bell Atlantic/NYNEX, *supra* at ¶¶ 140-143. Until such data and information is available, the Commission is in no position even to begin to evaluate WorldCom/MCI's generalized contentions. With this in mind, however, the following points may still be made with respect to the generalized arguments advanced in the Joint Reply.

First, as Simply Internet pointed out in its pending Motion for Review of Non-Public Materials,³ WorldCom/MCI's contention that there is no separate "Internet backbone" services market is not correct. Within the overall Internet industry, the IBP market is generally viewed as a separate and distinct market with its own particular competitive circumstances. It is clearly separate from the consumer dial-up access market, where competition is extremely vigorous among the approximately 4,500 ISPs. MCI and WorldCom would have the Commission incorrectly bunch all

³ See Simply Internet, Inc., Motion for Immediate Review of Non-Public Materials (filed Feb. 10, 1998).

these services under the same umbrella for purposes of defining a market.

WorldCom/MCI allege that they control only 20% of the Internet market, based on estimated Internet industry overall Internet revenues figures of \$2.3 billion. (Joint Reply, p. 76, fn. 124). This incorrectly uses overall Internet industry revenues to calculate market share. By trying to measure their Internet market share by looking at their revenues as a percentage of the overall industry revenue figures, WorldCom/MCI would evade the relevant issue -- which is their domination of the distinct IBP market within that overall market. If they want to use revenues as measure of market share, WorldCom/MCI should at least supply information as to their overall revenues as a percentage of the specific IBP market -- of which they exercise almost 50% control measured on the basis of all connections to ISPs.

Second, Simply Internet strongly disagrees with WorldCom/MCI's generalized assertion that no barriers exist to entry to the IBP market. The conclusion that "any communications company that wishes to become a backbone provider can do so by purchasing the appropriate TCP/IP equipment and connecting such equipment to the transmission facilities it leases or owns" (Joint Reply, p. 69) is a completely unsupported assertion which does not accurately portray the marketplace. Becoming a successful backbone provider involves far more than simply buying some equipment and calling up the local phone company for a service line.

There are, in fact, substantial barriers to successful entry in the Internet backbone marketplace. Any company seeking to become a backbone provider faces substantial initial start-up costs for equipment, and even more substantial costs to obtain leased-line facilities from Tier 1 backbone providers such as MCI and WorldCom -- and then only to face competing with these carriers head-on for the same customer base, which is already substantially controlled by MCI and WorldCom with 50% market share.

Obviously, as heavily relied upon by WorldCom/MCI, other companies who are developing substantial fiber optic networks exist and are growing. However, none commands any measurable percentage of marketshare with respect to the provision of transmission capacity to competing Tier 2 IBP's, as do MCI and WorldCom -- who thus exercise substantial control over facilities leased to Tier 2 IBP's. This is the type of specific information that WorldCom/MCI should be supplying, rather than the largely theoretical and academic discussion set forth in its Joint Reply. The number of competing Tier 2 ISPs that rely on them for leased line facilities should be a significant factor in any meaningful competitive analysis, yet it is completely lacking in the current record.

Third, despite their contentions otherwise, the potential for abuse of market power by WorldCom/MCI by virtue of their substantial control over Internet Protocol ("IP) address space is quite substantial. The direct link

between IBP services and IP address space gives the IBP very substantial power over the ISP. IP address allocations are essential to the routability of an ISP's traffic over the global Internet. An IP number is the equivalent of a "host" address on the Internet and is what allows the host to be located. IP block allocations are rigidly controlled by the American Registry for Internet Numbers ("ARIN") (<http://www.arin.net/>), and are extremely difficult to obtain.

According to industry sources, less than 10% of all ISPs own their own routable IP blocks. Due to the conditions of scarcity, the vast majority of ISPs typically must "borrow" IP block allocations from the "upstream" IBP from whom they purchase Internet backbone connectivity. Unlike ISPs, IBPs such as MCI and WorldCom have ownership over very substantial IP block allocations.

If an ISP desires to switch its IBP, it typically must give up the "borrowed" IP address block that it was allocated by the IBP along with its Internet backbone connection. Losing an existing IP address block requires an ISP to obtain a new address block from its new IBP. This is a complex, time-consuming and delicate process involving not only the renumbering of the ISP's own servers, but the assignment of new IP addresses to all customers who have been in some manner assigned IP address space, including DNS, virtual hosting, and point-to-point connectivity. Renumbering may take days or weeks, depending on the

complexity of the network and/or number of affected customers. Down-time places ISPs in substantial danger of disruption and customer losses, and creates a flux of customer service problems and expense. These substantial problems provide a strong disincentive for an ISP to disconnect from its existing IBP.

Simply Internet disagrees with WorldCom/MCI's assertion that the ability to obtain routable IP address blocks from ARIN under IANA guidelines, if they have "a need for at least a few thousand IP addresses or connectivity to multiple ISPs" (Joint Reply, pp. 79-80) solves the problem. This is simply preposterous. As discussed above, the vast majority of ISPs do not qualify for their own IP address blocks under IANA guidelines and are forced to borrow the numbers from those few entities such as MCI and WorldCom that control vast address blocks.

MCI and WorldCom again try to evade the issue through a largely operational-level discussion of the dynamic IP routing of dial-up access customers. WorldCom/MCI correctly point out that most dial-up access customer activity is dynamically routed. This is done at the ISP level, meaning the customer does not need to perform any renumbering in the event his or her ISP changes address blocks. However, as previously discussed, in order for the ISP to change to another IBP, the ISP must renumber its entire network, which can severely effect its service to both dedicated access customers (who would also have to renumber their host

computers according to the ISP's new address assignment) and indirectly to dial-up customers who may lose service from the ISP for the period of time the ISP renumbers. In the extremely competitive ISP market, this creates the potential for significant customer losses if the ISP is compelled to renumber.

Fourth, WorldCom/MCI wrongly attempt to frame the peering issue as merely one of dedicated access involving a "transit function" versus a peering arrangement which does not involve the transit function (Joint Reply, pp. 82-88). WorldCom/MCI would like the Commission to believe that being a dedicated access customer is the better way for a new IBP to interconnect because of the so called "transit function." It is surely beneficial for WorldCom/MCI to sell 45 Mbps (DS-3) dedicated access capacity to a competing IBP instead of providing a peering arrangement giving the IBP access to all of MCI and WorldCom's ISP customers. From the perspective of an IBP attempting to compete with MCI and WorldCom in the IBP market, however, peering access to deliver traffic to all MCI and WorldCom's ISP customers is key to providing reliable IBP service. The current Internet model depends on free and open peering arrangements between IBP competitors. This is especially true for the smaller competitors of MCI and WorldCom who must be in a position to guarantee their customers access to all routes on the Internet, many of which are controlled by MCI and WorldCom, without having to pay MCI and WorldCom in some cases

millions of dollars per year for the access through "dedicated arrangements" at multiple network access points (NAPs). In its Petition to Deny, Simply Internet has already pointed out WorldCom's aggressive peering policies which can require substantial payments from IBPs that WorldCom deems do not qualify for peering. This policy alone constitutes a substantial entry barrier for potentially competitive IBPs.

In this respect, WorldCom/MCI's contention that they would not exercise substantial control over NAPs must be placed in context. As their pleading suggests, WorldCom currently controls at least two of the four major NAPs in the United States. The fact that there may be 42 NAPs in North America has little relevance. The more relevant question is the extent to which MCI and WorldCom peer with or are able to exercise control over these other NAPs. If MCI and WorldCom do not peer in those other NAPs, then IBPs in those NAPs are deprived of the ability to access MCI and WorldCom's ISP customers on an equal basis.

**III. Under Established Procedures, the Commission
Has an Affirmative Obligation to Develop a
Complete Factual Record and Make it Available
to the Parties for Analysis and Comment.**

The utter lack of meaningful data or other information in the WorldCom/MCI Joint Reply further supports Simply Internet's pending request that the Commission obtain and make available additional information filed by WorldCom/MCI

with the Justice Department pursuant to the Hart-Scott-Rodino Amendment to the Clayton Act ("HSR"). The information being collected by the Justice Department is essential for the Commission's ability to determine the impact of the proposed merger on the overall telecommunications marketplace and, in particular, the Internet marketplace.

The Justice Department is currently collecting HSR documentation from WorldCom/MCI and its competitors on a wide range of Internet related issues, focusing on the Internet backbone marketplace. Some of the information being requested reportedly includes specific data regarding network volume, traffic routing patterns, and breakdowns of traffic by customer category.⁴ Obviously, the Justice Department is concerned with the potential for anticompetitive consequences of a concentration of control over the Internet backbone and is gathering appropriate information for its review. This Commission must do likewise.

Simply Internet has previously urged the Commission to obtain the following information from WorldCom/MCI, and to make it available for inspection by the parties:

- (1) Internet backbone provider market share to ISPs and dedicated line customers;

⁴ "WorldCom, MCI Probe is Widened," Wall Street Journal, March 10, 1998, at A3; "Justice Depart. Seeks Detailed Internet Data in Review of WorldCom-MCI Merger," Communications Daily, March 11, 1998, at 2.

- (2) Internet dial-up market share;
- (3) Market share with respect to Internet peering (interconnection) points;
- (4) Market share with respect to actual fiber facilities leased to all other Internet backbone providers or Internet service providers;
- (5) Method of calculation of market share in each market;
- (6) Pricing information/history for service provision in each market;
- (7) Peering negotiations and contracts;
- (8) Ownership and control of Internet Protocol address blocks;
- (9) Percentage of overall ISP and other dedicated line Internet backbone customers "borrowing" or "renting" the IP addresses.

In light of the reported interest by the Justice Department regarding the impact of the WorldCom/MCI merger on the Internet, much of this same information may be part of the HSR documents that have been or will be submitted by WorldCom/MCI. The Commission must also have access to that information so that it can satisfy its own statutory obligation to determine whether the proposed merger is in the public interest. Furthermore, this information must

also be made available for public scrutiny to create a fair and complete record upon which the Commission can act.

There is ample precedent for the Commission to request HSR documents, and for making those documents available to parties challenging a proposed merger or acquisition. For example, in reviewing the Bell Atlantic/Nynex merger, the Commission obtained HSR documents and placed redacted versions in the public record.⁵ Similarly, HSR documents concerning AT&T's acquisition of McCaw Cellular Communications were requested by the Commission and made available to counsel for parties challenging the acquisition.⁶ To the extent that WorldCom/MCI may be concerned with public review of confidential and proprietary information, that concern can be addressed through appropriate confidentiality agreements and restrictions on the use and dissemination of HSR documents reviewed by third parties. Such procedures were used in the AT&T/McCaw case, and could be adapted for use in this proceeding as necessary.

The current record is devoid of information necessary for the Commission to determine that the merger of WorldCom and MCI would not inhibit competition in the critical Internet backbone marketplace. To date, WorldCom/MCI has none nothing to rectify that situation and is apparently of the view that it will not release any information unless

⁵ Bell Atlantic/NYNEX, *supra* at ¶ 28.

specifically forced to do so by the Justice Department or the FCC. However, unless the necessary information is made available for Commission and public scrutiny, the proposed merger cannot be said to be in the public interest and must not be allowed to proceed. The only alternative is for the Commission to order immediate evidentiary hearings as required by Sections 214 and 309 to resolve "substantial and material questions of fact" now presented by the application.

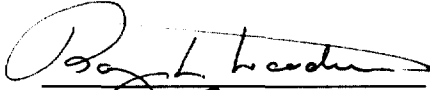
CONCLUSION

Both in its original application and now in its Joint Reply, WorldCom/MCI have woefully failed to supply the fundamental economic marketplace information required by the Commission to evaluate the competitive implications of their merger on the Internet backbone marketplace under clearly established Commission standards set forth in BellAtlantic/NYNEX and other recent cases. In stark contrast, Simply Internet and others have made a *prima facie* showing that the merger would lead to excessive concentration and adversely affect competition in the backbone marketplace essential for the future growth and development of the Internet. The circumstances require the Commission to obtain the necessary economic marketplace information, and make it available to the parties for their

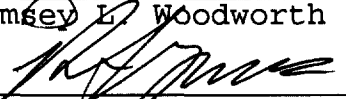
⁶ In re Applications of Craig O. McCaw and American Telephone and Telegraph Company, Memorandum Opinion and Order, 9 FCC Rcd 5836 (1994).

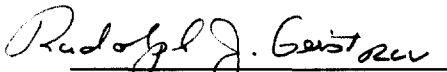
analysis and comment, before the WorldCom/MCI application
may be further considered.

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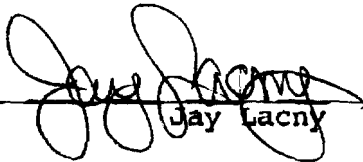
DECLARATION

Under penalty of perjury, Jay Lacny hereby states as follows:

1. I am President of Simply Internet, Inc.

I have read the foregoing Comments of Simply Internet, dated March 13, 1998, which I understand is to be filed with the Federal Communications Commission.

To the best of my personal knowledge and belief, the facts contained therein are true and correct.


Jay Lacny

March 13, 1998

CERTIFICATE OF SERVICE

I, Ramsey L. Woodworth, hereby certify that a copy of the foregoing "Comments of Simply Internet in Response to WorldCom/MCI Joint Reply" was served this 13th day of March 1998, by first-class, postage prepaid mail to the following:

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